



INTERNAL AUDIT

Inventory Controls for Water and Sanitary Sewer Line Repairs

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Authorization

The City Auditor has conducted an audit of Inventory Controls for Water and Sanitary Sewer Line Repairs. This audit was conducted under the authority of Resolution #2013-46 and in accordance with the Annual Audit Plan approved by the League City, City Council.

Objective

The objective of this audit is to determine if accountability exists for the inventory assets.

Scope and Methodology

The City Auditor conducted this audit in accordance with Generally Accepted Government Auditing Standards except this audit function has not had an external peer review. Those standards require planning and performing the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for the findings and conclusions based on the audit objectives. The City Auditor believes that the evidence obtained provides a reasonable basis for the findings and conclusions based on the audit objectives.

To adequately address the audit objective and to describe the scope of work on internal controls, the City Auditor has:

- Inquired with the Manager regarding general accountability over the Line Repair Inventory, segregation of duties, documentation, safeguarding of assets and reporting requirements
- Observed the premises where the inventory is stored to include the small tools inventory
- Calculated the approximate value of purchases for FY11, 12 and 13

The deficiencies in internal control that are significant within the context of the audit objective and based upon the audit work performed are stated in the Opportunities for Improvement section starting on page 2.

Background

The Line Repair Inventory is located in the Warehouse and behind the Warehouse at 1505 Dickinson Ave. The inventory consists of materials to repair water and sanitary sewer line breaks. The inventory does include brass parts. The Warehouse is shared with three other departments: Facilities, Traffic and Traffic Control. The facility has several video cameras on site. The primary security device for inventory is fencing and a padlock. The outside gate is card controlled. The major inventory items are pipes, clamps and couplings. The order for more inventories is triggered

by a visual on the part of the supervisors. Generally, inventory is picked up at the vendor by a supervisor. There is no source of information for beginning balances, purchases, issuances and ending balances for any particular item. Research on the checks and p-card purchases indicated that each year approximately \$200,000 in purchases is made for inventory. Physical inventory counts are not taken. I found no controls to test; therefore, I offer opportunities for improvement.

Overall Conclusion

Significant deficiencies were found for Inventory Controls in the Line Repair Department. There is no one person accountable for the inventory. If management will implement the opportunities for improvement; significant improvement can be made.

Opportunities for Improvement

During the audit the City Auditor identified certain areas for improvement. The audit was not designed or intended to be a detailed study of every relevant system, procedure, and transaction. Accordingly, the Opportunities for Improvement section presented in this report may not be all-inclusive of areas where improvement might be needed.

- 1) The audit found no one who is accountable for the Line Repair inventory. This is an important item in the entire internal control framework. None of these opportunities for improvement are possible without someone accountable.

Recommendation: Suggest that someone be designated as Inventory Control Coordinator.

Management Response: I agree.

Action Plan: A job description will need to be created and funding will need to be made available through the budget process.

Implementation: Possible implementation date is 10/14. A supervisor could be assigned these duties until the position is filled.

- 2) Organizing the inventory is the first step. Currently, the inventory is located in different sections of the warehouse and outside the warehouse. While observing a sample inventory count the auditor observed some difficulty in staff finding the entire inventory for specific items. Additionally, in some cases there are no markings in the storage area notating where the specific inventory item is stored. Also, three other departments have storage and access to the warehouse and a couple telephone poles were found outside by the Line Repair area. Line repair inventory needs the whole warehouse. This also does not

provide for safeguarding of assets particularly brass parts. (Reference Pictures 1,2,3,4)

Recommendation: Organize the inventory for efficiency of picking the inventory and knowing where the entire inventory is located.

Management Response: I agree.

Action Plan: A supervisor will be assigned to organize the inventory to prepare for counting.

Implementation: Estimated completion date is 04/01/14.

- 3) In order to detect Fraud, Waste and Abuse it is necessary to know what your inventory amount (both in numbers and dollars are). This consists of having both a book inventory and physical inventory for comparisons.

Recommendation: After the organization (Step 1 above) is completed, a complete physical count of all items should be made. This will constitute the beginning balance.

Management Response: I agree.

Action Plan: The supervisor assigned to organize will oversee the counting of inventory.

Implementation: Estimated completion date is 06/01/14.

- 4) As stated previously, recordkeeping for inventory is very important. It must consist of beginning balance, purchases, issuances and ending balances. To facilitate the tracking of these numbers efficiency could be made with a computer information system. It has been ascertained that the current accounting system (AS400) has the capability to account for inventory. Training could be received by staff. It also has been found that the new accounting system will also have an inventory module. Since timing of the purchase becomes an issue; perhaps in the interim, a simple Excel spreadsheet could be used until the more sophisticated system can be used.

Recommendation: Once the physical inventory balances are input, recordkeeping for the inventories should commence. Suggest an Excel spreadsheet be used until the new accounting system is in place.

Management Response: I agree.

Action Plan: The spreadsheet that was used during the bid process has been modified to allow for keeping count and to determine the value of inventory items.

Implementation: Completed

- 5) The audit found no entries in the Comprehensive Annual Financial Statements regarding the inventory in Line Repair. The full disclosure principle of accounting is violated because inventory is a current asset and must be reflected in the books and records of the city.

Recommendation: Once the above first steps are completed, Line Repair communicates to the Finance department the value of the inventory.

Management Response: I agree.

Action Plan: Once the inventory items have been counted and entered into the spreadsheet, the value of the inventory will be communicated to the Finance Dept.

Implementation: Estimated completion date is 07/01/14

- 6) Access to the inventory should be controlled access only. It was observed that a fenced in area could be climbed and access gained. Additionally, other departments have access to the building. In one section of the warehouse that housed brass parts access was unimpeded. (Reference Picture 5)

Recommendation: To enhance the safeguarding of the inventory assets, all access points should be card controlled. This eliminates the accounting for all employees that might have keys. It is much more efficient and effective to simply deactivate a card than to collect keys from an employee. Ensure that fences completely protect the inventory assets.

Management Response: I agree.

Action Plan: This will need to be a group effort between the Facilities, IT, and Line Repair Departments. Funding will need to be available prior to implementation. Brass items stored in this area have been relocated to the chain link cage which is kept locked.

Implementation: Unknown completion date.

- 7) Segregation of duties is not present in the Line Repair department. Segregation of duties means no one person is in complete control of a transaction from beginning to end. It typically means that the authorization, recordkeeping, custody and reconciliation be done by different individuals. If this is not possible

then mitigating controls must be in place such as supervisory reviews. Particularly concerning was the fact that supervisors and crews can pick their own inventory for their jobs. Consequently, excess inventory could be picked and sold to a third party.

Recommendation: Suggest that someone be designated as Inventory Control Coordinator to provide for segregation of duties over the picking of inventory.

Management Response: I agree.

Action Plan: See response #1

- 8) What applies to the material inventory also should apply to the small tools inventory. The small tools inventory is kept in a separate room in the front part of the warehouse. The door can remain open at times to allow crews to pick up their radios. Towards the back of this room various small tools are visible such as shovels. The remaining small tools such as reflective vests, goggles, and bug spray are kept in locked closets. One closet was unlocked upon the auditor's visit. Some of these small tools can be used at the home. Therefore, it is important to track this inventory. (Reference Picture 6 and 7)

Recommendation: Suggest that someone be designated as Inventory Control Coordinator to be accountable for the small tools inventory.

Management Response: I agree.

Action Plan: See response #1

- 9) The department had video cameras to monitor the movement of personnel and parts; however, they were not all functional. Poor lighting and dirty lenses contributed to this situation. Additionally, the manager did not have access to view the camera video in real-time.

The IT director corrected this situation during the audit.

- 10) There were no policies and procedures found regarding the ordering, picking, recording, and storage of inventory.

Recommendation: Develop policies and procedures regarding inventory and have all employees read them and certify they have read them.

Management Response: I agree.

Action Plan: Once the previous items are addressed, written policies and procedure will be developed and employees will be required to read and sign off on them.

Implementation: 10/01/14

EXHIBIT A

Sampling Methodology

The items to be counted were taken from the Bid Tabulation Sheet and judgmentally selected based on the unit price or total dollar amount. A total of 23 items were selected. Some were not in stock and therefore not counted. The purpose of the count was for the auditor to gain a greater understanding of the location of inventory, the identification of inventory, the safeguarding of inventory and any other problems associated with the inventory controls.

Picture 1



Line Repair Inventory in the yard

Picture 2



Clamp Inventory inside the warehouse

Picture 3



Line Repair Inventory in the yard

Picture 4



Poles intermingled with Line Repair Inventory

Picture 5



Unlocked gate leading to three other departments

Picture 6



Small tools – This portion was unlocked at time of visual

Picture 7



Small Tools Inventory – This was in a locked closet